IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No. 297 of 1995

For Approval and Signature:

HONOURABLE MR.JUSTICE D.A.MEHTA
HONOURABLE MS.JUSTICE H.N.DEVANI

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1 Whether Reporters of Local Papers may be allowed to see the judgment ?

2 To be referred to the Reporter or not ?

3 Whether their Lordships wish to see the fair copy of the judgment ?

4 Whether this case involves a substantial question of law as to the interpretation of the constitution of India, 1950 or any order made thereunder ?

5 Whether it is to be circulated to the civil judge ?

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KAILASH IVESTMENTS PVT LTD - Applicant(s)

Versus

COMMISSIONER OF INCOME TAX - Respondent(s)

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Appearance :
MR RK PATEL for applicant assessee

MR MANISH R BHATT for respondent revenue
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CORAM : HONOURABLE MR.JUSTICE D.A.MEHTA
and
HONOURABLE MS.JUSTICE H.N.DEVANI

Date : 26/08/2005

ORAL JUDGMENT

(Per : HONOURABLE MR.JUSTICE D.A.MEHTA)

1. Income Tax Appellate Tribunal, Ahmedabad Bench "B" has referred the following three questions of law under Section 256(1) of the Income Tax Act, 1961 (the Act) at the instance of the assessee.

> "(1) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in confirming the disallowance of commutation charges of Rs.12,01,782/- and in holding that the same was not business loss admissible either under section 28 or section 37 of the Act?
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> (2) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in rejecting the alternative claim of the appellant to the effect that the same was allowable as deduction u/s 57(iii) of the Act?
>
> (3) Whether, on the facts and in the circumstances of the case, the

Tribunal was justified in rejecting the second alternative argument of the appellant to the effect that the said amount represented capital loss u/s 45 of the I.T. Act, 1961 and ought to have been given full effect thereto?"

2. The assessment year is 1978-79 and the relevant accounting period is the year ended on 30th September 1977. The assessee company, a wholly owned subsidiary company of Karamchand Premchand Pvt. Ltd. (KPPL) had issued share capital divided into 1,11,000 shares of face value of Rs.100 per share. KPPL was holding 1,10,998 equity shares, while remaining 2 shares were held by nominees of KPPL. It appears that first and final call of Rs.90 per share was due from KPPL on 27/7/1973. The Board of Directors of the assessee company, therefore, resolved to call upon KPPL to make payment of Rs.90 per share towards first and

final call on or before 11/8/1973.

3.KPPL, in its turn, having sold some of its industrial undertakings to another wholly owned subsidiary company, Sarabhai Chemicals Pvt. Ltd. (SCPL), was entitled to recover a sum of more than Rs.3.95 crores from SCPL over a period of eight years from 1/7/1974 onwards, the last installment being receivable on 1/7/1981. KPPL, therefore, after obtaining consent of SCPL, proposed to the assessee company to transfer and assign a sum of Rs.99,89,820/- from the aforesaid receivable amount from SCPL to the assessee company. The Board of Directors of the assessee company met on 10/8/1973 and passed a resolution accepting the said proposal. This resulted in a tripartite agreement between the assessee company, KPPL and SCPL. According to the terms of agreement, the assessee company was to receive the total amount of Rs.99,89,820/-

towards first and final call due from KPPL from SCPL in eight equal annual installments, each installment being of Rs.12,48,727=50. Accordingly, the deed of assignment was signed by the three parties on 22nd September 1973. It is an admitted fact that the assessee company received first three installments and as on 30th September 1976, a sum of Rs.62,42,365/- was outstanding.

4. In the meantime, ownership of SCPL changed hands and SCPL became division of M/s Elscope Pvt. Ltd. On 28/6/1977, the assessee wrote to SCPL proposing to convert the outstanding receivable in annual installments into an amount receivable on demand and for this purpose, a discount of 12% was offered. On SCPL agreeing to the proposal, the due amount was reduced to Rs.50,40,483/-, and the same was placed in a current account with SCPL. The sum of Rs.50,40,483/- was to carry interest at a

rate which was equivalent to the rate of interest chargeable by bankers on working capital to SCPL from time to time. The assessee became entitled to interest from the date of such conversion on the balance outstanding. Accordingly, as on 30th June 1977, an amount of Rs.12,01,782/- was commuted being the discount and the assessee claimed the said amount as a deductible expenditure of the year under consideration.

5. Before the assessing officer, it was claimed that the aforesaid commutation charge namely, discount granted to SCPL was a business expenditure or business loss and the assessee was entitled to deduction under Section 37 or under Section 28 of the Act. Alternatively, it was claimed that the same was allowable as a deduction under Section 57(iii) of the Act. A further alternative claim was that, if it was to be treated as a capital loss, it should be

allowed to be carried forward and set off against capital gains which may arise in future, in accordance with law. The assessing officer rejected all the claims and the assessee carried the matter in appeal before CIT (Appeals), but failed. The CIT (Appeals) having confirmed the assessment order, the assessee carried the matter in second appeal before the Tribunal, but the Tribunal also upheld the decision of the CIT (Appeals) confirming the assessment order.

6.Mr.R.K.Patel, the learned advocate appearing on behalf of the applicant assessee submitted that it was in the course of business of the assessee company that it was required to give discount to SCPL and hence, the commuted amount of Rs.12,01,782/- was a deductible expenditure, or at least was a business loss, and was deductible before arriving at the figure of profits and gains of business under Section 28

of the Act.

7. The Tribunal has found, as a matter of fact, that the commutation by way of discount was relatable to debt which was owed to the assessee company originally by KPPL and thereafter, by SCPL towards call moneys due from a shareholder. In other words, it was a debt due to the assessee on capital account, and therefore, could not be regarded as either business loss admissible under Section 28 of the Act, or a business expenditure deductible under Section 37 of the Act. In light of the facts set out hereinbefore, it is not possible to find any infirmity in the order of the Tribunal on this count. It is also necessary to take note of the fact that the claim of the assessee that it was engaged in the business of holding of investments was not accepted by the assessing officer and the CIT (Appeals). The activities of the assessee were treated as

relatable to income from investment attributable to other sources. Though this was challenged before the Tribunal, the ground was not pressed, and hence, as a matter of fact, it has become final that the assessee company was not carrying on any business of holding of investments. In these circumstances, issuance of share capital and receipt of call money against the same account have no relevance to holding of investments under the head “Income from other sources”. Therefore, the Tribunal was justified in holding that the assessee was not entitled to any deduction under Section 28 and / or under Section 37 of the Act.

8. The alternative claim for deduction under section 57(iii) of the Act has been rejected by the Tribunal, holding that the transaction was on capital account and therefore, the loss cannot be regarded as having been incurred for the purposes of making or earning any income,

which is the pre-requisite condition for allowability of a deduction under Section 57(iii) of the Act. In fact, the provision requires incurring of an expenditure which is laid out or spent wholly and exclusively for the purpose of making or earning income from other sources. As already noticed, the entire debt is relatable to issuance of share capital and is, thus, on capital account. No expenditure has in fact been incurred for the purposes of earning or making income. Accordingly, the finding of the Tribunal that the assessee was not entitled to deduction under Section 57 (iii) of the Act does not require any interference.

9. The second alternative contention to grant the claim of assessee of having incurred capital loss under Section 45 of the Act has not been accepted by the Tribunal in the following words:

> “..... The original debt in the present case had arisen out of transaction of issue of share capital and the loss had been quantified only when the debt had been commuted but the same had actually arisen when the assessee accepted the debt payable in future against the call money due in presenti which had a lower value than call money due. We accordingly reject the ground.....”

10. In this connection, Mr.Patel invited attention to the definition of the term “capital asset” as laid down in Section 2(14) of the Act and the term “transfer” as laid down in Section 2(47) of the Act. Placing reliance on a decision of this Court in the case of Commissioner of Income Tax, Gujarat III v. Minor Bababhai alias Lavkumar Kantilal, [1981] 128 ITR 1, it was submitted that the agreement by way of proposal and acceptance of proposal

between the assessee company and SCPL resulted in a novatio entitling the assessee to a capital loss. That there was transfer of the original debt due from KPPL and / or SCPL when the terms were modified whereunder the assessee company agreed to give discount, or forgo a sum by way of commutation and instead receive a reduced amount which was payable on demand as against the outstanding five installments. According to him, this amounted to extinguishment of right to the extent of commutation. The amount forgone by the assessee company was, thus, extinguishment of right to recover the said amount from the total amount due to the assessee company, resulting in capital loss which should be allowed to be carried forward. He also placed reliance on the decision of the Apex Court in the case of Commissioner of Income Tax v. Mrs. Grace Collis, [2001] 248 ITR 323, to emphasize as to what would constitute extinguishment of right

within the meaning of definition of the term “transfer” under section 2(47) of the Act.

11.Mr.M.R.Bhatt, the learned senior standing counsel appearing on behalf of revenue supported the order of Tribunal by submitting that the charge of capital gains was under Section 45 of the Act, which requires transfer of a capital asset before gains or loss could be worked out. He, therefore, urged that there was no reason to disturb the finding of the Tribunal.

12.The facts as recorded hereinbefore make it amply clear that the assessee company was to receive call money towards shares issued to KPPL. KPPL got substituted by SCPL and the period over which the call money liability was to be discharged got extended over a period of eight years. Thereafter, three annual installments were received and then the terms

of payment underwent change once again, whereunder the assessee company agreed to forgo the sum of Rs.12,01,782/-. However, the basic fact that the moneys were receivable against shares issued to KPPL remained as it is without any change or modification. The only change that kept on taking place from time to time was in relation to the terms of payment, including the payer and the period, but the nature of payment remained the same, namely, call moneys payable towards shares issued by the assessee company. Once this position is clear, it is apparent that the amount that assessee company was to receive is towards share capital and would be its liability. Under Section 211 of the Companies Act, 1956, the form of balance sheet (including the contents thereof) are laid down as per Part 1 of Schedule VI. SHARE CAPITAL appears as item No.1 on the LIABILITIES side. Therefore, at no point of time, was the assessee in possession of or entitled to any

asset. In absence of any asset, there can be no question of any extinguishment of rights. Therefore, the basic condition for invoking Section 45 of the Act, namely, transfer of capital asset does not get fulfilled. Even if the submission on behalf of the assessee that there is a transfer because of extinguishment of rights can be said to have some substance, extinguishment of rights pre-supposes extinguishment of rights in an asset which is in existence. In absence of the basic requirement being satisfied, there is no question of any capital loss being incurred by the assessee which will entitle the assessee to carry forward the same under the head “capital gains” as appearing in Chapter IV Part E.

13.In the circumstances, it is not possible to find any infirmity in the order of Tribunal, rejecting the claim of the assessee that the amount forgone by the assessee represented

capital loss under Section 45 of the Act.

14. Accordingly, all the three questions are answered in the affirmative i.e. in favour of the revenue and against the assessee. The Reference stands disposed of accordingly. There shall be no order as to costs.

[D.A.MEHTA, J.]

[HARSHA DEVANI, J.]

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